

DEPARTMENT OF STATE REVENUE

LETTER OF FINDINGS NUMBER: 96-0517

**Adjusted Gross Income Tax
For The Period: 1991 Through 1994**

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Adjusted Gross Income Tax – Throwback

Authority: IC 6-3-2-2; 45 IAC 3.1-1-64; P.L. 86-272

The taxpayer protests the imposition of adjusted gross income tax.

STATEMENT OF FACTS

The Taxpayer distributes electronic equipment throughout the United States, Canada, and Latin America. In addition to distribution activities, taxpayer is also responsible for marketing and servicing its products in North and South America. The taxpayer has three divisions: Branded products, original equipment manufacturer products (OEM), and customer service and support. The branded products division offers products such as printers, scanners, and personal computers. The OEM division supplies a wide range of OEM products throughout North, Central, and South America. The products marketed by OEM include integrated chips, floppy disks, memory cards, and power supplies. The customer service and support division provides support for customers both before and after the sale. Customer support handles customer relation issues, warranty administration, and technical assistance.

The taxpayer agrees that the Department's adjustment of adjusted gross income tax for state income taxes, property taxes, and charitable contributions was correct. The taxpayer also agrees to the property factor adjustment for rent expenses and inventory. The only issue still in protest, is whether or not the adjustment for throwback sales was proper.

Additional facts will be provided below as necessary.

I. Adjusted Gross Income Tax – Throwback Sales

DISCUSSION

The question is whether the taxpayer's business activities within the United States, Canada, and Latin America exceeded the protection of P.L. 86-272.

During the audit period, the taxpayer maintained thirteen (13) regional offices in the US, two (2) in Canada, and six (6) in Latin America. The regional offices were responsible for sales, service, and customer support. Taxpayer also owned three warehouse distribution centers in the United States and rented several public warehouses within the US and Taiwan.

Since 1988, the taxpayer has been filing income and/or franchise tax returns in all states that impose such a tax. Sales and use tax returns have also been filed by the taxpayer in each applicable state.

During the period under audit, the taxpayer frequently sent samples to customers of each division for their use in evaluating its products. Most of the samples were free except those provided by the OEM division. In the electronics industry, it is common practice for a distributor to loan evaluation units and demonstration products to its customers as consigned goods. In the case of an evaluation unit, the customer is entitled to use the equipment for 60-90 days then either purchase or return the product to the taxpayer. During this evaluation period the taxpayer retains title to the product. Demonstration products were provided for store displays, training, and building customer goodwill. The customer could use the product from six (6) to twelve (12) months and then either purchase or return the product to the taxpayer. The taxpayer always maintained title to the merchandise until it was sold.

During the audit period, the taxpayer expensed software, hardware, and other equipment if it was \$2,000 or less. Many of these items were used by regional sales and service representatives for their home offices or at trade shows.

Merchandise returned by a branded products customer was usually handled by the local authorized dealer. The dealer would take possession of the unit on behalf of the taxpayer and then return the unit to one of the taxpayer's distribution centers. Regional sales personnel for the branded products division were also authorized to pick up products at the customer's location. Products returned by an OEM customer were usually processed by the local sales representative. If a customer's account was delinquent, taxpayer's credit manager from corporate headquarters and regional sales personnel would visit the customer and arrange for special payment terms or pick up. If the customer was going out of business, and unable to pay, the credit manager would visit the customer and take possession of the product.

During the audit period, the taxpayer distributed advertising materials and other promotional literature through sales personnel located in each state. Taxpayer also advertised in local newspapers, trade journals, and telephone books.

Taxpayer reported payroll expenses in 29 states, although they were present in all 50 states, Canada, and Latin America. The taxpayer's sales personnel worked out of their homes and reported to a local regional office. The sales representatives solicited orders, investigated credit worthiness, arranged for deliveries, and handled customer complaints. The sales representatives also called on delinquent accounts. Problems with defective or damaged merchandise were handled by regional sales personnel. The sales and service personnel are authorized to pick-up or replace damaged merchandise at the customer's location.

In 1988 the taxpayer established a wholly-owned subsidiary to offer the taxpayer's products directly to the retail marketer rather than through a reseller. The taxpayer and its subsidiary were closely tied in terms of activities. They shared the same office and warehouse space and utilized the services of the regional sales and service personnel. Since 1989 the taxpayer's subsidiary has been filing income and/or franchise tax returns in at least 15 states (see taxpayer's exhibit VIII). Many of these states were unitary states in which the taxpayer and its subsidiary filed a combined return.

The taxpayer argues that its activities in conjunction with the activities of local and regional personnel were more than sufficient to exceed the protection of P.L. 86-272. The taxpayer contends that through the distribution of samples, evaluation units, and demonstration units the taxpayer maintained inventory in each state. The taxpayer states that it owned 100% of the Canadian and Latin American subsidiaries. The foreign sales offices owned inventory, property, and equipment in their respective countries. The taxpayer argues that it established nexus with Canada and Latin America through the ownership and activities of its subsidiaries. In addition, the taxpayer sent employees overseas on a regular basis to oversee the foreign offices.

Indiana's throwback rule under IC 6-3-2-2(e) reverts the sales and receipts to the state from which the goods are shipped in situations where federal constitutional restrictions or Public Law 86-272 deprives the purchaser's state of the power to impose a net income tax. 45 IAC 3.1-1-64. Accordingly, the phrase "taxable in the state of the purchaser" (See IC 6-3-2-2) refers to the power of the purchaser's state to tax the entity, whether or not the power has been exercised. IC 6-3-2-2(n). The throwback rule is designed to prevent the taxpayer from obtaining a windfall. If the destination state lacks the power to levy the tax because of limitations imposed by the Constitution or by congressional legislation, the attribution of the sale for sales factor purposes to some state is justified.

In Wisconsin Department of Revenue v. William Wrigley Jr. Co., 505 U.S. 214 (1992), the United States Supreme Court interpreted the term "solicitation" for purposes of P.L. 86-272, the federal law that generally exempts a corporation from state income tax if the company's only activity in the state is solicitation of sales of tangible personal property. Wrigley also established

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PAGE #4

that a *de minimis* amount of nonsolicitation activity will not cause a corporation to lose its exemption from state taxation under P.L. 86-272.

In this case, the taxpayer's activities in the other states, Canada, and Latin America are sufficient for those states to impose taxation. Therefore, the taxpayer's protest is sustained.

FINDING

The taxpayer's protest is sustained.